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August 8, 2002

Via Electronic Filing
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: *Application by Verizon New England and Verizon Delaware for Authorization to Provide In-Region, InterLATA Services in New Hampshire and Delaware, Docket 02-157*

Dear Ms. Dortch:

On Wednesday, August 7, 2002, David Levy, Michael Lieberman, and the undersigned, all representing AT&T, met with Aaron Goldschmidt, Richard Kwiatkowski, Victoria Schlesinger and Carol Canteen of the Wireline Competition Bureau's Pricing Policy Division. Participating by telephone were Richard Walsh on behalf of AT&T and Julie Saulnier of the Pricing Policy Division. The purpose of this meeting was to provide Staff with an overview of the non-recurring charge and rate benchmarking issues AT&T will raise in its reply comments to be filed in the above-referenced proceeding. As part of the discussion, AT&T provided the attached motion for summary judgment and supporting brief filed by AT&T with the U.S. District Court on August 5, 2002, in *AT&T Communications of Delaware, Inc. v. Verizon Delaware, Inc., et al.*, C.A. No. 02580 (SLR) (D. Del.). In the District Court lawsuit, AT&T challenges the non-recurring charges approved by the Delaware PSC for Verizon as unlawful under the 1996 Act, the 1996 *Local Competition Order* of this Commission, and the decision of the same court in *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F.Supp.2d 218 (D. Del. 2000).

One electronic copy of this Notice is being submitted to the Secretary of the FCC in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

Amy L. Alvarez

cc: Gary Remondino
Victoria Schlesinger
Henry Thaggert
Tracey Wilson
Ann Berkowitz (Verizon)

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August 5, 2002

The Honorable Sue L. Robinson
United States District Court
844 King Street
Lock Box 31
Wilmington, DE 19801

RE: **AT&T Communications of Delaware, Inc. v. Verizon Delaware, Inc., et al.**
Complaint for Declaratory and Injunctive Relief
C.A. No. 02-580 (SLR)

Dear Judge Robinson:

Plaintiff AT&T has today filed a motion for summary judgment and its Opening Brief in support thereof in the above-referenced matter. As Your Honor will recall, this dispute has its genesis in Your Honor's prior opinion in *Bell Atlantic-Delaware, Inc. (now known as Verizon-Delaware) v. McMahon*, 80 F. Supp. 2d 218 (D. Del. 2000)("*McMahon*"), which issued on January 6, 2000. In *McMahon*, Your Honor remanded several matters to the Delaware Public Service Commission ("PSC") for further proceedings, including the critical issue of the non-recurring rates that Verizon could charge its competitors such as AT&T for access to Verizon's network. Your Honor held that the non-recurring rates established by the PSC were not "forward-looking" as required by the applicable legal standard, as Verizon had relied upon the mechanization of its existing network to establish those rates, which the Court deemed "irrelevant." 80 F. Supp. at 251.

As set forth in the Complaint in the instant matter, and in the Motion and accompanying Opening Brief filed today, notwithstanding the clear directive of *McMahon*, Verizon re-filed a non-recurring rate schedule which, once again, relies upon Verizon's existing, inefficient systems and its plans for mechanization thereof. These are exactly the same bases rejected by the Court in *McMahon*.

On July 16, 2002, Verizon received an endorsement from the PSC in support of its application to be filed with the Federal Communications Commission (the "FCC") seeking approval to offer in-region long distance service originating here in Delaware. Among other things, the application will likely turn upon the purported compliance of the non-recurring rates with federal law, and Your Honor's earlier order in *McMahon*.

Given the exigencies of the circumstances, including the likelihood that the FCC will take action quickly on Verizon's pending application to offer long distance service in Delaware, it is critically important to bring this matter before the Court as soon as possible. To that end, pursuant to Local Rule 7.1.4, AT&T requests oral argument on its Motion for Summary Judgment and respectfully requests that argument be scheduled as soon as may be convenient for the Court upon the expiration of the briefing schedule imposed by Local Rule 7.1.2(2), (3).

We include herewith courtesy copies of AT&T's Motion and Opening Brief for the convenience of the Court. It does not appear that the record has been sent up from the Commission, as yet. However, once it has been, we anticipate that we will be able to prepare a joint appendix and formal citations to the record will be inserted in the Brief at that time.

Respectfully submitted,

Wendie C. Stabler

WCS:nlf
Enclosure
cc: Dr. Peter T. Dalleo, Clerk (w/enclosure)
William E. Manning, Jr., Esq. (w/enclosure)
Gary A. Myers, Esq. (w/enclosure)

UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

AT&T COMMUNICATIONS OF DELAWARE, INC., a Delaware corporation, Plaintiff, vs. VERIZON DELAWARE, INC., a Delaware corporation; the PUBLIC SERVICE COMMISSION OF THE STATE OF DELAWARE; and ARNETTA MCRAE, Chairman, JOSHUA M. TWILLEY, Vice Chairman, DONALD J. PUGLISI, Commissioner, JAMES B. LESTER, Commissioner, AND JOANN P. CONAWAY, COMMISSIONER in their official capacities as Commissioners of the Public Service Commission of the State of Delaware, and not as individuals, Defendants.	)	Case No. 02-580 (SLR)

MOTION FOR SUMMARY JUDGMENT

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, AT&T Communications of Delaware, Inc. ("AT&T") hereby moves for summary judgment as there are no genuine issues of material fact and AT&T is entitled to judgment as a matter of law.

The grounds for the motion are fully set forth in AT&T's Opening Brief in Support of its Motion for Summary Judgment filed contemporaneously herewith.

By:_____

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UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

AT&T COMMUNICATIONS OF DELAWARE, INC., a Delaware corporation,	)	
Plaintiff,	)	Case No. 02-580 (SLR)
vs.	)	
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Defendants.	)	

CERTIFICATE OF SERVICE

I, Kimberly L. Gattuso, hereby certify that on August 5, 2002, a copy of the foregoing **Motion for Summary Judgment and Brief of AT&T Communications of Delaware, Inc. in Support of Its Motion for Summary Judgment** was served in the manner indicated on the below-named:

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UNITED STATES DISTRICT COURT
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BRIEF OF AT&T COMMUNICATIONS OF DELAWARE, INC. IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

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NATURE AND STAGE OF PROCEEDINGS

This suit challenges an order of the Public Service Commission of the State of Delaware ("PSC") establishing certain rates imposed by Verizon Delaware, Inc. ("Verizon") known as non-recurring charges ("NRCs") for unbundled network elements ("UNEs") provided to competitors of Verizon such as AT&T Communications of Delaware, Inc. ("AT&T"). *See* Findings, Opinion, and Order No. 5967 (June 4, 2002). AT&T challenges the methodology employed by Verizon to establish these rates, which is violative of federal law and this Court's decision remanding the NRCs to the PSC in *Bell Atlantic-Delaware, Inc.* v. *McMahon*, 80 F. Supp. 2d 218 (D. Del. 2000) ("*McMahon*"). The action is brought pursuant to 47 U.S.C. § 252(e)(6) and 28 U.S.C. §§ 1331 and 1337. *See generally Verizon Maryland Inc.* v. *PSC of Maryland*, 122 S. Ct. 1753 (2002).

AT&T filed its Complaint on June 25, 2002. The PSC filed its Answer on July 23, 2002. Verizon filed its Answer on July 26, 2002.

INTRODUCTION AND SUMMARY OF ARGUMENT

This is a simple case. Indeed, it is the same case that this Court decided more than two years ago in *McMahon*. There, this Court found that certain NRCs that the PSC had established for Verizon violated the Telecommunications Act of 1996 ("the Act" or "1996 Act") and the implementing regulations promulgated by the Federal Communications Commission ("FCC"), because the rates were based on Verizon's existing, inefficient processes rather than, as the FCC's controlling rules require, the most efficient technology available. In remanding the case to the PSC so that it could set new rates, the Court expressly prohibited the PSC from relying on Verizon's current processes as a basis for determining NRCs. *See McMahon*, 80 F. Supp. 2d at 251 ("[t]he mechanization of [Verizon's] current internal service order processes is *irrelevant* to the legal standard for determining network element costs") (emphasis added) (citing 47 C.F.R. § 51.505(b)(1)).

The Defendants have flouted this Court's mandate. As the PSC's Staff, the Division of the Public Advocate ("DPA") and the PSC's own Hearing Examiner all concluded, the PSC has again established NRC rates for Verizon that are improperly based on Verizon's existing manual processes, rather than on more efficient, commercially available electronic processes. Indeed, the "new" Verizon NRCs are a step backwards; NRCs for many key processes are *higher* than those that were struck down as being based upon existing inefficient systems in *McMahon*.

The invalidity of Verizon's NRC rates was not a close question in *McMahon*, and cannot be a close question now. The "new" NRC rates are based on the same

methodology that this Court in *McMahon* found violated the Act and the governing FCC rules, and, accordingly, directed the PSC not to use.

Moreover, fundamental principles of administrative law independently require the PSC's Order to be vacated. For example, the PSC did not acknowledge, much less address, the express findings of its own Hearing Examiner and Staff that Verizon's cost model was still improperly based on its existing systems and processes. In addition, the PSC provided no explanation for its failure to adopt AT&T's appropriately forward-looking cost model. Finally, the PSC acknowledged that the model used by Verizon to calculate its NRCs was a "black box," but the PSC accepted Verizon's NRCs without making any attempt to determine if Verizon properly implemented even its flawed embedded cost approach.

For these reasons, the Court must vacate the PSC's Order. It should do so expeditiously because, through the Defendants' utter disregard of this Court's explicit remand directive, Verizon has utilized its virtual monopoly to dominate and control the local telecommunications market despite the intention of Congress in the Act to open local markets to competition and now seeks to extend that monopoly to the long distance market.

BACKGROUND

To place the issues in their full context requires discussion of (1) the 1996 Act, (2) the FCC regulations, and (3) the PSC proceedings.

1. 1996 Act. Prior to the enactment of the 1996 Act, incumbent local exchange carriers ("ILECs") such as Verizon enjoyed a state-sanctioned monopoly in the provision of local telephone services for business and residential consumers within their designated service areas. Verizon is the incumbent provider of local telephone service in the State of Delaware. Guaranteed the opportunity to realize a profit free from competition,

ILECs such as Verizon built ubiquitous local telephone networks in their service areas, and thus came to exercise exclusive control of the facilities through which consumers receive all local and long-distance telecommunications services. *See AT&T Corp.* v. *Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999). *See also McMahon*, 80 F. Supp. 2d at 222 (the ILEC "owns all of the equipment and lines necessary to provide local telephone service").

In 1996, Congress passed the Act which was designed to open up, on a nationwide basis, monopoly markets for local telephone service to full, effective, and fair competition. *McMahon*, 80 F. Supp. 2d at 222. Congress recognized, however, the practical reality that competition would take years to develop (and in some areas might not develop at all) if local entry required each new entrant to replicate the local services infrastructure network. Accordingly, "[t]he Act also attempts to alleviate some of the natural barriers to entry in local telecommunications markets" by imposing certain affirmative duties on ILECs which permit new local carriers to enter the competitive market by using the incumbent's facilities or services. *Id.*

One of those duties is that the ILEC must allow new local carriers to enter the competitive market by leasing the piece parts of the ILEC's network – called unbundled network elements (or "UNEs"). 47 U.S.C. § 251(c)(3). A new entrant can use these UNEs, either in whole or in combination with its own facilities, to offer any telecommunications service. *See McMahon*, 80 F. Supp. 2d at 223 ("This allows new entrants to fill in the gaps of their own network by purchasing pieces of an ILEC's network"). Section 251(c)(3) requires that rates, terms, and conditions for these network elements be just, reasonable, and nondiscriminatory, and section 252(d)(1) further mandates that those rates be based on the cost

of providing the elements, without reference to the rate of return or other rate-based proceedings that prevailed in the prior monopoly era.

The rates for network elements include both "recurring" charges and "non-recurring" charges. Recurring charges are the monthly or other charges for the lease (or use of capacity in) network elements during a period of time. Non-recurring charges, by contrast, are one-time charges that compensate the incumbent LEC for processing orders for elements and for physically provisioning them. *See also McMahon*, 80 F. Supp. 2d at 250 ("Non-recurring costs ('NRCs') are the one-time expenses incurred by an ILEC when it switches one of its subscribers to a new entrant").

2. The FCC's Regulations. Congress directed the FCC to promulgate regulations implementing the Act's local competition provisions. 47 U.S.C. § 251(d)(1). In the *Local Competition Order*,[1] the FCC adopted rules that implement sections 251(c)(3) and 252(d)(1) by requiring that prices for unbundled network elements be set under a cost methodology known as Total Element Long Run Incremental Cost ("TELRIC"). TELRIC measures the "forward-looking long run economic cost" of providing a network element and it "best replicates, to the extent possible, the conditions of a competitive market." *Local Competition Order* ¶¶ 525, 672; *see id.* ¶¶ 672-732; 47 C.F.R. §§ 51.501, 51.503, 51.505. Thus, rather than looking at an ILEC's "actual" or historical costs of its existing facilities and

[1] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report & Order, 11 FCC Rcd. 15499, ¶ 525 (1996) ("*Local Competition Order*"), *aff'd in part, vacated in part, Iowa Utils. Bd.* v. *FCC*, 120 F.3d 753 (8th Cir. 1997) ("*Iowa Utils Bd.*"), *aff'd in part, rev'd in part, AT&T Corp.* v. *Iowa Utils Bd.*, 525 U.S. 366 (1999), *on remand, Iowa Utils. Bd.* v. *FCC*, 219 F.3d 744 (8th Cir. 2000), *rev'd in relevant part sub nom Verizon Comm. Inc.* v. *FCC*, 121 S. Ct. 877 (2001).

processes used in providing a UNE, TELRIC-based rates "measure[ ] . . . the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. § 51.505(b). As the FCC determined, prices based on TELRIC are "critical to the development of a competitive local exchange [market]" and will "best ensure the efficient investment decisions and competitive entry contemplated by the 1996 Act." *Local Competition Order* ¶ 705. If prices for network elements exceed TELRIC levels, then competitors will incur greater costs than the incumbent in using essential facilities; efficient entry by competitors cannot occur; and the result can be "price-cost squeezes" that foreclose competition. *Id.* ¶¶ 635, 675, 705. Under the FCC's rules, the TELRIC methodology *must* be used to set both the recurring charges and the non-recurring charges for network elements. *See* 47 C.F.R. § 51.507(e).

Although the FCC's pricing rules were challenged by the ILECs, the Supreme Court has definitively upheld them in two separate decisions. In *AT&T Corp.* v. *Iowa Utils Bd., supra*, the Supreme Court affirmed the FCC's jurisdiction to adopt pricing rules that must be followed by state regulatory commissions in setting UNE rates. *AT&T*, 525 U.S. at 366. More recently, in *Verizon Communications Inc.* v. *FCC*, 122 S. Ct. 1646 (2002), the Supreme Court upheld the FCC's TELRIC pricing rules in their entirety. In so doing, the Supreme Court concluded that the Act was "an explicit disavowal of the familiar public-utility model of rate regulation . . . in favor of novel rate setting designed to give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property." *Id.* at 1661. In this regard, the Supreme Court observed, "[u]nder the local-competition provisions of the Act, Congress called for ratemaking different from any historical

practice, to achieve the entirely new objective of uprooting the monopolies that traditional rate-based methods had perpetuated." *Id.* at 1660.

3. The Delaware PSC Proceedings.

This case, as did *McMahon*, arises out of the PSC's review of Verizon's UNE prices under section 252 of the Act. That section establishes a "hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rates." *Verizon*, 122 S. Ct. at 1661.

The PSC first reviewed Verizon's UNE prices when Bell Atlantic-Delaware (now Verizon-Delaware or "Verizon DE") first proposed UNE rates in the "Phase I" proceedings. The PSC's decision in those proceedings ultimately was appealed to this Court in *McMahon* and remanded back to the PSC. A full understanding of the issues in this case requires discussion of this first round of proceedings and this Court's remand, as well as the "Phase II" proceedings that produced the decision now before the Court for review.

The "Phase I" Proceedings. On December 16, 1996, Verizon DE filed with the PSC an application for approval of its Statement of Generally Available Terms ("SGAT") under the Act.[2] The SGAT included both recurring and non-recurring rates for UNEs. The Commission referred the SGAT to a panel of Hearing Examiners.

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[2] *Application of Bell Atlantic Delaware Inc. for Approval of its Statement of Terms and Conditions Under Section 252(f) of the Telecommunications Act of 1996*, PSC Docket 96-325 (filed December 16, 1996). Pursuant to 47 U.S.C. § 252(f), an ILEC may file with a state commission an SGAT that it offers within that state. The SGAT must be approved by the state commission to ensure compliance with sections 251 and 252. New entrants may then purchase (continued . . .)

After three rounds of consideration by the Hearing Examiners and the PSC, the PSC issued its Phase I Order (PSC Order No. 4542) adopting recurring and non-recurring rates on July 8, 1997. *See McMahon*, 80 F. Supp. 2d at 225-26 (summarizing Phase I proceedings). In that rate order, the PSC largely adopted Verizon's approach with respect to NRCs.

Verizon described the methodology of its Phase I model for establishing NRCs as follows:

> The nonrecurring cost studies identify the costs for completing each task associated with the provision of service to a CLEC. The studies, which are in a spreadsheet form, are premised upon the number of minutes to complete each function, times the applicable labor rate for the person who would be performing the function.

Brief of Bell Atlantic Delaware, Inc. at 102 (March 7, 1997). The testimony of Verizon's witness made clear that Verizon's cost studies were based on the company's anticipated mechanization of its manual systems and processes. *See* Rebuttal Testimony of Gary Sanford at 26 (Apr. 9, 1997) ("Sanford Rebuttal") ("BA-Del's service order issuance cost reflects an assumption that we will mechanize the internal process of issuing orders" by a certain percentage per year over five years). With respect to processes that Verizon did not plan to mechanize, its proposed costs were based on its existing manual processes.[3]

(. . . continued)
UNEs directly at the rates set forth in the SGAT or the parties may incorporate by reference the rates, terms and conditions set forth in the SGAT in an interconnection agreement.

[3] *See, e.g.*, Sanford Rebuttal at 27-28 ("BA-Del's study properly includes notification to the CLECs . . . This time reflects the time necessary to identify the appropriate CLEC to contact, prepare the FAX, and transmit the FAX. This function may be mechanized in the future, but since we have no idea at this point what that mechanization will cost, there is no basis to assume that the manual process is more expensive than the mechanization"); *id.* at 29 (continued . . .)

The District Court Remand. On September 8, 1997, Verizon filed an action for Declaratory and Injunctive Relief with this Court requesting, *inter alia*, that this Court overturn the recurring rates set by the PSC for the use of Verizon's network, and claiming that those rates violated the 1996 Act. AT&T counterclaimed that the NRCs established by the PSC in Phase I were not cost-based and were not TELRIC compliant. Specifically, AT&T argued that the NRCs adopted by the PSC in Order No. 4542 did not reflect the rates that an efficient LEC would provide for fully-mechanized electronic interfaces and systems for ordering, provisioning, billing, and related non-recurring operations, but, rather, allowed Verizon to collect NRCs based on Verizon's inefficient, and more costly, antiquated manual processes.

In the *McMahon* decision, this Court concluded that both the Hearing Examiners and PSC had failed to adhere to the governing TELRIC standard in setting Verizon's NRCs because "their analysis focused entirely on the reasonableness of the future mechanization of Bell's *current* manual service order processing system." *McMahon*, 80 F. Supp. 2d at 250 (emphasis in original). As the Court explained, this was a fundamental TELRIC error. Specifically, the NRCs could not be forward-looking because they were based on Verizon's embedded processes for providing UNEs:

> The mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs. At no point in their analysis did the Hearing Examiners address Bell's proposed NRC charges in

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(. . . continued)
("[A]ssignment costs are manual costs incurred to assign cable and pairs to loops and a location on the line side of the switch for ports. BA-Del is currently not required to mechanize this process. If and when this process is mechanized, these savings will be passed along to BA-Del's retail and wholesale customers").

> light of 'the most efficient telecommunications technology currently available and the lowest cost network configuration.' 47 C.F.R. § 51.505(b)(1). There is simply no mention of the 'most efficient, currently available' telecommunications technology – even though the Commission since has conceded that Bell's service order processing system does not meet this standard . . . . Where, as here, an agency ignores a controlling legal standard, its rulings are arbitrary and capricious. *See Florida Power & Light Co.*, 470 U.S. at 743.

McMahon, 80 F. Supp. 2d at 251.

Recognizing that the PSC would need to develop a factual record to determine the forward-looking costs that a carrier using the most efficient technology currently available (*i.e.*, fully-mechanized electronic processes) would incur to provide the UNEs, the Court "remand[ed] the NRC charge issue to the [PSC] for renewed evidentiary hearings consistent with the *Local Competition Order* and its implementing regulations, specifically, 47 C.F.R. § 51.505(b)(1)." *Id.*

The "Phase II" Proceedings. Verizon did not respond quickly to the Court's directives. Rather, it waited almost a year and a half after *McMahon* to submit a "Revised UNE Rate Filing" to the PSC on May 24, 2001, which prompted the PSC to initiate the Phase II proceeding. PSC Order No. 5735 (June 6, 2001). Verizon nevertheless sought expedited consideration of Phase II based upon its claim that permission to enter the in-region long distance market under section 271 of the Act, 47 U.S.C. § 271, could not be granted in the absence of TELRIC-compliant UNE rates.

The PSC appointed a Hearing Examiner to conduct proceedings. Verizon presented what it characterized as a "new" non-recurring cost model ("Verizon NRCM"). *See* Direct Testimony of Ann A. Dean (June 15, 2001) ("Dean Direct"); Rebuttal Testimony of Ann A. Dean and Michael E. Peduto (October 9, 2001) ("Dean and Peduto Rebuttal"). The model purported to measure the "forward-looking" costs of the tasks necessary to provide

UNEs. But as Verizon candidly acknowledged, its "new" model – just like its prior study – took as its starting point Verizon's existing systems. *See, e.g.*, Brief of Verizon Delaware Inc. at 49 n. 146 (Nov. 13, 2001) ("the baseline for the [Verizon] NRC Model is the network as it exists today"); *id.* at 50 ("a snap-shot of the current environment is a logical and reasonable starting point"). Indeed, Verizon's stated position was that "[t]he actual real world and the existing infrastructure . . . may be used – and indeed *must* be used – as a starting point to the derivation of rates in a manner consistent with TELRIC. Without some reference to and basis in reality, it is impossible to create rates that have any relation to the *costs that will be incurred by Verizon DE.*" *Id.* at 49 (second emphasis added).

The Verizon NRCM was based on surveys of Verizon employees concerning the times it actually took them to perform the various tasks necessary to provision certain UNEs, utilizing Verizon's existing systems and processes. *Id.* at 50 ("The survey process undertaken by Verizon DE quite sensibly began with an assessment of the tasks performed in the current environment"); Dean Direct at 4 ("The new non-recurring cost model for UNEs uses *current average work times* as the starting point") (emphasis added); *id.* at 28 ("The work times in the model were developed based on surveys of Verizon's personnel who are actually involved in the relevant work functions under study"). Verizon then "adjust[ed] the average work times reported by the people who do the work by a forward-looking adjustment factor, reflecting technology and productivity enhancements. These forward-looking adjustment factors were developed by a panel of Verizon experts with experience in provisioning UNEs and with state-of-the-art technology." Nov. 13 Verizon Brief at 50.

Significantly, no record was kept of the meetings of the panel of in-house "experts" who determined the forward-looking adjustment factors. Nor did they produce any report or documentation explaining how the adjustments were made (and no such documentation was submitted with Verizon's model). And only a *fraction* of Verizon's proposed NRCs received "forward-looking" adjustments and for the most part, NRCs were based strictly on existing processes. Direct Testimony of Richard J. Walsh at 9 (Sept. 14, 2001) ("Walsh Direct") ("Although Verizon applies some 'forward-looking adjustments' to current work times and occurrences, such adjustments are *not widespread across all work activities*") (emphasis added).

There can be no pretense that the survey process, which is indisputably based on Verizon's embedded systems, yielded forward-looking cost estimates. Significantly in this regard, the instructions that Verizon provided to its panel reveal that the panel was directed to do exactly what this Court said was improper:

> The Panel will review the current time estimates . . . and then . . . discuss *anticipated mechanization*, and process improvements specifically related to each activity/UNE combination to determine the forward-looking adjustment factor for that combination . . .

Dean Direct, Exhibit L (emphasis added). Further, the Verizon "experts" were instructed to base their judgments only on anticipated improvements to Verizon's existing systems:

> the forward looking adjustment . . . represents what *we expect to achieve* in 'the most efficient environment'

Id. (emphasis added). *See also* Dean Direct at 9 ("The costs are based on future reasonably expected and planned mechanized advancements"); *id.* at 11 ("the new non-recurring cost model reflects Verizon-DE's expectations of flow-through in the future"); Dean and Peduto

Rebuttal at 17 (the forward-looking adjustment factor "projects the effects of expected OSS improvements and Verizon-DE's initiatives on the ability to process a request in a mechanized manner"). To provide an example, Verizon's witness stated that "[o]ne forward-looking adjustment is an anticipated 50% improvement in the performance of the Regional CLEC Coordination Center due to an anticipated mechanized advancement." Dean Direct at 35. Accordingly, even with Verizon's "forward-looking" adjustments to some of its work times, its proposed NRCs were still based on its actual costs incurred with its embedded systems. Dean and Peduto Rebuttal at 15-16 ("For non-recurring costs, Verizon-DE *will incur* labor and other costs required to fulfill CLEC orders based on the network infrastructure, systems, and processes that are utilized going forward. This network will contain both old and new technologies, and the forward-looking economic non-recurring costs Verizon-DE *will incur* are those of fulfilling orders in *this network*") (emphasis added).

To provide a concrete example, AT&T demonstrated the flaws in Verizon's methodology by examining Verizon's proposed charge for provisioning a "hot cut," which involves disconnecting the loop (the connection to the customer's premises) from Verizon's switch (its main computer which routes volumes of incoming and outgoing calls), and reconnecting it to another carrier's switch in order to terminate a call to the customer at the other end. AT&T noted that Verizon's NRCM listed four hours of manual coordination activities by its Regional CLEC Coordination Center ("RCCC") associated with the cutover, such as making phone calls to confirm the order and coordinate the timing of the cut, which was reduced to two hours by a "forward-looking" adjustment. Initial Brief of AT&T at 40 (Nov. 13, 2001) ("Nov. 13 AT&T Br."); Walsh Direct at 42 ("Verizon asserts that for every

[hot cut] order, the (RCCC/RCMC) will contact the CLEC and ask them if it really meant to do the work"); *id.* at 43 ("Verizon identifies coordination time to schedule work-teams"). AT&T demonstrated that, even with the adjustment, the manual coordination costs are not consistent with a forward-looking efficient network environment because the coordination functions can be performed electronically by modern OSS. Nov. 13 AT&T Br. at 39-41; Walsh Direct at 43 ("Verizon's tasks reflect the inefficiencies of not using the OSS as they were designed to be used"). Accordingly, Verizon's proposed charge is substantially inflated because it assumes two hours of manual coordination activities that would be unnecessary if the most efficient available technology were used. Indeed, under Verizon's model, these coordination activities in fact take "substantially longer than the work effort that is actually required to provision an order." Nov. 13 AT&T Br. at 40.

AT&T advocated forward-looking NRCs derived from its own model (the "AT&T NRCM"), which "calculates pre-ordering, ordering, provisioning and disconnecting non-recurring costs for 49 Network Element types" based upon the processes that would be used by an efficient carrier unconstrained by an outdated legacy system. Walsh Direct at 54. Accordingly, AT&T's proposed NRCs were well below those proposed by Verizon. The methodology of AT&T's NRCM is "very simple" and can be summarized as follows:

> First, all activities required to complete a Local Service Request ("LSR") are identified and listed. Second, for each activity, an estimate is provided of the amount of time (in minutes) required to perform each activity . . . [M]ost non-recurring activities are accomplished electronically for which, therefore, no time is captured. Third, once the time has been determined, the wage rate associated with the type of labor required for the specific activity is determined and the labor cost is calculated. The model is constructed to take into consideration the probability of an activity occurring . . . Fourth, the NRC Model calculates the cost

> of each of the activities . . . Finally, the model adds up the costs of the activities for each element type and then applies a variable overhead factor to calculate the total costs . . .

Walsh Direct at 52-53. The work times and probabilities for each activity "were determined by the consensus of a panel of experts within the telecom industry." *Id.*[4]

The Hearing Examiner issued Findings and Recommendations on December 21, 2001 (the "Initial Report"), finding that AT&T's NRCM was "forward-looking." Initial Report ¶ 247. He also found "understandable" the uniform criticism of Verizon's model. *Id.* Nevertheless, he recommended that the PSC adopt Verizon's NRCM. According to the Hearing Examiner, by adjusting its existing processes to reflect future improvements, Verizon made a "good-faith" effort to reflect a forward-looking environment. *Id.*

On January 29, 2002, the Commission met to deliberate and consider the Initial Report. Although the Commission adopted a number of the recommendations of the Hearing Examiner contained in the Initial Report, several of the Commissioners were "troubled" by his recommendation that the PSC adopt Verizon's NRCM. *See, e.g.*, PSC Jan. 29, 2002 Meeting Tr. at 2205, 2211. In particular, the Commissioners noted that the existing record did not sufficiently document how Verizon's proposed NRCs were derived. *See id.* at 2237, 2240. Ultimately, the Commission was unable to reach a decision on the NRCs and remanded the issue back to the Hearing Examiner, stating that "the record developed by the parties is not, in the Commission's opinion, sufficient to allow the Commission to render an informed decision

[4] Unlike the Verizon NRCM, the AT&T NRCM was open and extensively documented. Walsh Direct at 5, 7, 60.

on the issue of whether Verizon-Delaware's non-recurring cost model complies with the District Court's determinations and TELRIC and whether the rates produced are just and reasonable under the TELRIC's pricing standards." PSC Order No. 5896 at 1 (Feb. 19, 2002).

On remand to the Hearing Examiner, PSC Staff, the Public Advocate, Cavalier, and AT&T again showed that Verizon's use of existing processes and times (even "adjusted" for future efficiencies), constituted the exact approach rejected by the District Court. As AT&T explained:

> Verizon declined to follow the clear directive of the District Court and employed the same flawed methodology based on its existing network and processes.
>
> Verizon's cost developers asked the wrong question, i.e., what would *Verizon's* non-recurring costs be going forward, assuming that Verizon made its existing processes as efficient as it could be? Even if Verizon personnel then "adjusted" for "planned" efficiencies, that would not get Verizon to the answer to the right question, specifically, what would the forward-looking costs of an efficient carrier be in an efficient TELRIC compliant network?

Supplemental Filing of AT&T at 3 (Feb. 15, 2002) (emphasis in original); Initial Mem. of the Commission Staff on Remand at 8 (Feb. 15, 2002) ("[I]f the information revealed to date infers anything, it is that the Verizon employee panel did exactly what the District Court said should not be done: project UNE costs based on estimates of future incremental mechanization of Verizon's existing systems"); Public Advocate's Comments & Recommendations Concerning Remand Issues, at 4 (Feb. 15, 2002).

On February 28, 2002, the Hearing Examiner issued a ruling that reversed his earlier recommendation on the NRC issue, frankly acknowledging that he had erred in previously determining that the Verizon NRCM produced TELRIC-compliant rates. The

Hearing Examiner explained that he had previously recommended approval of the rates "as a practical matter" because "the alternative was to leave Delaware without an approved set of UNE rates for the foreseeable future." Hearing Examiner Remand Findings ¶ 17. *See also id.* ¶ 19 ("An express purpose for expediting the proceeding was to facilitate Verizon-DE's entry into the long-distance market in Delaware by providing a full set of permanent UNE rates for inclusion in Verizon-DE's imminent § 271 filing"). These "practical" considerations had apparently overridden the Hearing Examiner's admitted concerns with the Verizon NRCM, which he candidly acknowledged "starts with the existing network and task times (derived from a disputed survey process) and then relies heavily on internal, undisclosed judgments for converting current costs to forward-looking rates." *Id.* ¶ 17.

On remand (and after Verizon decided to proceed with its section 271 application irrespective of the status of the Delaware UNE proceeding), the Hearing Examiner recognized that these imperfections in the Verizon NRCM were in fact TELRIC violations. Indeed, the Hearing Examiner expressly found that the Verizon NRCM suffered from the exact same flaws that had caused the District Court to reject Verizon's original NRC model: the Verizon NRCM is based on Verizon's existing, inefficient manual processes, not (as TELRIC plainly requires) the most efficient, electronic processes that are currently available. As the Hearing Examiner explained:

> 21. In addition, Staff notes on remand that Verizon Delaware's main complaint is that without relying on its embedded systems as a starting point, it is "impossible to create rates that have any relation to the cost that will be incurred by Verizon-Delaware." *Id.* at 5, quoting Verizon-DE Opening Brief at 49. Staff argues, however, that:
>
> > seeking such a match is not the goal of TELRIC, which instead is designed to divine economic costs (47 C.F.R. §51.505) and which expressly prohibits the use of embedded costs. 47 C.F.R. §51.505(d)(1).

> As the District Court stated clearly, the mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs.

Id. at 6, quoting District Court Remand at 251.

> 22. For these reasons, on remand, I recommend that the Commission adopt Staff's interpretation of TELRIC and its position that Verizon-DE's NRCM falls short of the TELRIC standard and the District Court Remand.

Hearing Examiner Remand Findings ¶¶ 21-22.

The Hearing Examiner further explained that these conclusions were supported by the testimony of Verizon's own witnesses, who effectively conceded that the Verizon NRCM did not calculate costs based on the most efficient technology currently available, but instead used a "'what Verizon-DE will actually achieve' outlook." *Id.* ¶ 24 (citations omitted); *see also id.* at 23 (citing testimony of Verizon witness that "the NRCM was based on the network Verizon-DE *actually would have in place* at the end of a three-year planning period") (emphasis added). Finally, the Hearing Examiner also agreed with the parties' criticism that Verizon had failed to document its methodology for making so-called "forward-looking" adjustments to its existing processes, rendering that methodology a "black box" with no record support. *Id.* ¶¶ 25-26. Thus, even if Verizon's approach of beginning with its existing processes were appropriate, there was no way to judge the reasonableness of the "adjustments" that Verizon purported to make to those existing processes. *Id.* ¶ 26 ("Without documentation of the assumptions and conclusions of the [Verizon "experts"], the Commission cannot ascertain why a given technology or process was projected and why potential alternatives were rejected").

For these reasons, the Hearing Examiner recommended that the Commission "reject Verizon-DE's proposed non-recurring UNE rates because the NRCM violates the

TELRIC pricing standard and the District Court Remand and because Verizon-DE has failed to provide adequate support for the work times used as model inputs." *Id.* ¶ 43. The Hearing Examiner did not address AT&T's NRCM.

At its meeting on March 5, 2002, the PSC again considered Verizon's proposed NRCs. The Commissioners acknowledged that the methodology underlying the Verizon NRCM remained unclear. PSC March 5, 2002 Meeting Tr. at 2323 ("I do agree that what we have is a black box here") (Chairman McRae); *id.* at 2341 ("I'm not pleased with the lack of transparency here to this model") (Commissioner Puglisi); *id.* at 2345 (the NRCM "truly is a black box") (Chairman McRae). The PSC voted to "defer action on The Hearing Examiner's recommendation concerning the compliance of the nonrecurring cost model with the District Court's determination and TELRIC." *Id.* at 2362; *see also id.* at 2353-54 (Commissioner Puglisi: "We have not ruled on whether the model is compliant." . . . Chairman McRae: "I'm proposing we don't decide that."). Instead, the PSC directed Verizon to perform "re-runs" of the model. *Id.* at 2353-54. In particular, as the PSC later described its directive, Verizon was directed to take the survey responses and "compute for each task, in addition to the average time which Verizon-DE had used in its study, the mode time (the most frequently occurring number in the sample), the minimum time and maximum time." PSC Order No. 5967 ¶ 88 .

At the time, the PSC apparently planned to use the "re-runs" of the NRCM to establish interim rates, pending a more comprehensive examination of how permanent rates should be set. *See* PSC March 5, 2002 Hearing Tr. at 2339 ("[W]e can work these numbers and use this information, something with where I started, on an interim basis, the inputs. But

at the same time, instructing the parties to go back and use this methodology, such as what was set out in Staff's reply brief as to how we proceed, which is another model, actually") (Chairman McRae); *id.* at 2342-43 (describing "a much more comprehensive process" to take place to establish permanent rates) (Chairman McRae). The AT&T model was only mentioned in passing at the PSC's March 5 meeting, without any discussion. *See id.* at 2342 ("Then there is the AT&T model. I don't think we really did any major discussion of in here today, or in our last proceeding.") (Chairman McRae).

On April 9, 2002, Verizon filed the matrix of alternative rate runs (called the "Re-Run Matrix") requested by the Commission at its March 5, 2002 meeting and amended the filing on April 16, 2002 to correct minor errors. At its public meeting on April 30, 2002, the Commission considered the Re-Run Matrix, the Comments, Verizon's Reply Comments, and the oral argument of the parties. The entire focus of the Commission's deliberations was which "run," or combination of runs, of the NRCM should be used as the basis for permanent NRC rates. *See* April 30, 2002 Meeting Tr. at 2414-32. Significantly, there was no discussion, or even mention, of the critical issue that the Commission had previously deferred: whether the Commission should adopt the Hearing Examiner's recommendation that the NRCM be rejected as not TELRIC-compliant because it is based on Verizon's existing, inefficient processes. Nor is there any clue in the Commission's deliberations as to why it fundamentally shifted its focus, from whether the NRCM could be used *at all* to set permanent NRC rates, to instead taking that model as a given and merely determining how it should be fine-tuned to set the rates. Ultimately, the Commission adopted the Verizon NRCM, adjusted to reflect somewhat lower manual work times than what Verizon had originally proposed. At

the very end of the meeting, as an afterthought, one Commissioner suggested that the rates the PSC was adopting be deemed "TELRIC" "in light of the District Court's response previously." *Id.* at 2435. The Commission voted in favor of a motion to deem the NRC rates TELRIC-compliant "in the opinion of the Commission." *See id.* at 2435-36.

Order No. 5967 memorialized that meeting. In that order, the PSC acknowledged the criticisms leveled by Staff, AT&T, and the other parties that Verizon's NRCM is "flawed" in several respects, including that Verizon "fail[ed] to document its process for calculating the forward-looking adjustment." Order No. 5967 ¶ 84. The PSC therefore declined to approve "the [NRC] rates as proposed by Verizon-DE," *id.*, but it nevertheless used the Verizon NRCM. Specifically, the PSC concluded that "certain alterations to the inputs and assumptions of the model would allow the model to be used to produce TELRIC-compliant NRC rates." *Id.* ¶ 85. The PSC candidly acknowledged that using Verizon's flawed model with input alterations is not the "best way of calculating non-recurring rates," but nevertheless found that the results would be "TELRIC-compliant rates." *Id.*; *see also id.* ¶ 91 (finding that the adopted NRC rates "comply with the FCC's TELRIC methodology" and do not reflect "simply the cost to Verizon-DE of performing these tasks now or in the future").

Order No. 5967 is more noteworthy, however, for what it does *not* say. Consistent with the PSC's deliberations at its April 30 meeting (or more accurately, its *lack* of deliberations), Order No. 5967 made *no* findings on several key issues. For example, the PSC did not provide any reasoned explanation as to why it did not adopt AT&T's forward-looking cost model. In addition, the PSC wholly failed to address, or even mention, the Hearing

Examiner's conclusion that the NRCM cannot possibly satisfy the TELRIC standard (and, therefore, cannot possibly satisfy this Court's express remand directive in *McMahon*), because it "rel[ies] on [Verizon's] embedded systems as a starting point," rather than the most efficient processes available. Hearing Examiner Remand Findings ¶¶ 21-22. Similarly, even apart from Verizon's failure to look at the most efficient processes available rather than its existing processes, the PSC wholly failed to address, or even mention, the Hearing Examiner's express finding that the NRCM could not be relied upon because Verizon had not properly supported its purported "forward-looking" adjustments to its existing processes. Indeed, in stark contrast to other portions of Order No. 5967, the NRC portion makes no mention at all of the Hearing Examiner's conclusions and recommendations. The PSC also failed to explain why the recommendations of its own Staff and the Division of the Public Advocate should be rejected.

AT&T filed its Complaint for Declaratory and Injunctive Relief with the U.S. District Court on June 25, 2002.

STANDARD OF REVIEW

Section 252(e)(6) of the Act requires this Court to determine whether the PSC's Order and the terms of the SGAT that it has approved "meet[] the requirements" of §§ 251 and 252 of the Act and the FCC's implementing regulations. *McMahon*, 80 F.Supp.2d at 227. This Court "shall conduct a review of the administrative record as it existed before the Commission." *Id.* Because a state agency's interpretations of federal law are entitled to no deference, this Court uses a "*de novo* standard of review" to determine "whether the Commission's actions were procedurally and substantively in compliance with the Telecommunications Act." *Id.* This Court uses the "'Administrative Procedure Act's

'arbitrary and capricious' standard in its review of the Commission's application of the law to the facts." *Id.*

In reviewing the PSC's Order under the "arbitrary and capricious" standard, this Court's task is not merely to "rubber-stamp" the decision. *See Neighborhood TV Co. Inc.* v. *FCC*, 742 F.2d 629, 639 (D.C. Cir. 1984). Rather, the Court must conduct a "searching and careful" inquiry, *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971), in order to assure that the agency has "examine[d] the relevant data and articulate[d] . . . a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). In this regard, it is black-letter law that the agency cannot announce one standard and apply another. *See, e.g., New England Coalition on Nuclear Pollution* v. *NRC*, 727 F.2d 1127, 1130 (D.C. Cir. 1984); *Squaw Transit Co.* v. *United States*, 574 F.2d 492, 496 (10th Cir. 1978). Nor can the agency simply ignore pertinent arguments or considerations. *Motor Vehicles Mfrs. Ass'n*, 463 U.S. at 43 (1983) ("An agency rule would be arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem."); *Professional Pilots Fed.* v. *FAA*, 118 F.3d 758, 771 (D.C. Cir. 1997) (same).

ARGUMENT

PSC Order No. 5967, which adopts excessive NRCs for Verizon-DE, flies in the face of this Court's *McMahon* remand decision, which unequivocally held that the PSC cannot set NRCs on the basis of Verizon's existing processes. Yet the PSC has now done exactly that, *a second time*, turning a blind eye to this Court's ruling and the express requirements of the Act and the FCC's implementing regulations. The Court therefore has no choice but to act quickly to enforce its prior order and to ensure that Verizon's currently

captive Delaware consumers enjoy the full benefits of fair and open competition as envisioned and mandated by Congress.

The PSC's approval of inflated NRCs for Verizon-DE flouts the pro-competitive intent of the 1996 Act and will further entrench Verizon's local exchange monopoly. Excessive NRCs are a significant barrier to entry into local markets because they are, by definition, charges that competitors pay but that incumbents like Verizon do not. *See, e.g.*, *AT&T Commun.*, 103 FCC 2d 77, 94 (1985) ("It is evident that nonrecurring charges can be used as an anticompetitive weapon to . . . discourage competitors"); *Expanded Interconnection with Local Telephone Company Facilities*, 8 F.C.C.R. 7341, 7360 (1993) ("absent even-handed treatment, non-recurring reconfiguration charges could constitute a serious barrier to entry"). Verizon has succeeded in erecting such an insurmountable barrier to entry in Delaware. Its NRCs are so high that ubiquitous, effective competition is simply not possible. This state of affairs is intolerable and should not be allowed to continue. The Court should vacate Order No. 5967 and direct the PSC and Defendant Commissioners to set appropriate NRCs based on the Act and the FCC's pricing regulations.

1. The NRC Rates Set By The PSC Are Unlawful And Violate *McMahon*.

The NRCs approved by the PSC and Defendant Commissioners in Order No. 5967 violate the Act, the FCC's binding pricing rules, and this Court's *McMahon* decision. As this Court correctly recognized in *McMahon*, "[w]here, as here, an agency ignores a controlling legal standard, its rulings are arbitrary and capricious" and must be reversed. *McMahon*, 80 F. Supp. 2d at 251.

The controlling legal standard is undisputed (and has not changed). As this Court correctly recognized in *McMahon*, "NRC charges, like all network element charges,

must be based on the cost of providing the network element. *See* 47 U.S.C. § 252(d)." 80 F. Supp. 2d at 250. Under the FCC's controlling TELRIC standard, "[t]he NRC charges, then, must 'be based on the use of the *most efficient* telecommunications technology *currently available* and the lowest cost network configuration.' *See* 47 C.F.R. § 51.505(b)(1) (emphasis added)." *Id.* There can be no doubt that the Act and the FCC's regulations prohibit reliance on Verizon's *existing* network and processes as a basis for determining NRCs, and the Court made an explicit finding so stating: "The mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs." *Id.* at 251.

Nor can there be any dispute that the NRCs adopted by the PSC violate this controlling legal standard, as well as this Court's explicit remand instructions in *McMahon*. As described above, the Hearing Examiner specifically examined the testimony submitted by Verizon and concluded that, despite this Court's instructions, Verizon had not separated its cost study "from a 'what Verizon-DE will actually achieve' outlook, which undermines the TELRIC requirement of long run costs incurred by a carrier utilizing the most efficient telecommunications equipment currently available." Hearing Examiner Remand Findings ¶ 25. No other finding could have been reached, as Verizon's own witnesses conceded that NRCs were based on existing processes modified, in some cases, by "planned" enhancements. *See* Dean Direct at 9 ("The costs are based on future reasonably expected and planned mechanized advancements"); Dean and Peduto Rebuttal at 17 (the forward-looking adjustment factor "projects the effects of expected OSS improvements and Verizon-DE's initiatives on the ability to process a request in a mechanized manner"); Nov. 13 AT&T Brief at 29 ("Verizon

has repeated the exercise of measuring the non-recurring costs of its current network and processes and, then, adjusting them based upon 'anticipated mechanization.' . . . This is precisely the approach denounced by the District Court") (*quoting* Dean and Peduto hearing testimony).

The other independent parties in the proceeding also showed that while Verizon's NRCM was labeled as "forward-looking" it was actually an embedded historical cost study that only assumed changes that Verizon already planned to make to its existing legacy processes, and did not, as required by the TELRIC rules, estimate the costs of the most efficient processes that could be used to provide UNEs to competitors. For example, the PSC Staff demonstrated that "Verizon has been candid in representing: (1) that the starting point for [its cost study] process was the design of its current systems and the work tasks associated with those systems and (2) that adjustments were made to reflect expected enhancements to these systems, based on the opinions of a panel of in-house experts whose expertise lie in Verizon's existing processes, existing systems, and the company's existing plans to mechanize those systems." Staff's Initial Mem. on Remand at 6. *See also* PSC Staff's Opening Post-Hearing Brief at 8 (Nov. 13, 2001) ("Verizon nevertheless performed its Phase II nonrecurring cost study by utilizing the very same methodology the District Court Order expressly rejected"). And the Public Advocate showed that "Verizon's proposed rates for Non-Recurring Charges (NRCs) do not reflect 'the use of the most efficient telecommunications technology currently available and the lowest cost network configuration' and, thus, they violate the directive stated at pages 75-77 of the January 6, 2000 Opinion of the U.S. District Court for the District of

Delaware in the Bell-Atlantic SGAT appeal." Reply Brief of the Public Advocate at 25 (Nov. 20, 2001).

In light of the testimony of Verizon's own witnesses and the conclusions of neutral parties such as the PSC Staff, the Department of Public Advocate and the PSC's own Hearing Examiner that Verizon's NRCM is an embedded cost study, Verizon's attempt to characterize its model as forward-looking and based on the most efficient technology currently available is simply unavailing. *See* Answer of Verizon Delaware Inc. ¶¶ 21, 24, 30, 32, 41 (July 26, 2002) ("Verizon Answer"). In particular, Verizon now characterizes its "forward-looking" adjustments as "reflect[ing] the most efficient forward-looking technologies and process improvements available." *Id.* ¶ 30; *see also id.* (the "forward-looking" adjustments were used "to reduce current times to reflect the impact of using the most efficient technology currently available and the lowest cost network configuration"). As described above, Verizon's current characterization is inconsistent with the instructions provided to the panel that determined the adjustments, and is inconsistent with the testimony of Verizon's own witnesses. *See, e.g.*, Dean Direct, Exhibit L (The Panel will review the current time estimates . . . and then . . . discuss *anticipated mechanization*, and process improvements specifically related to each activity/UNE combination to determine the forward-looking adjustment factor for that combination . . .) (emphasis added); *id.* (the forward looking adjustment . . . represents what *we expect to achieve* in 'the most efficient environment') (emphasis added); Dean and Peduto Rebuttal at 17 (the forward-looking adjustment factor "projects the effects of expected OSS improvements and Verizon-DE's initiatives on the ability to process a request in a mechanized manner").

Moreover, Verizon's attempt to label its NRCM as "forward-looking" does not make sense on its own terms. If the panel assembled by Verizon was truly charged with identifying task times underlying its proposed NRCs that "reflect the most efficient forward-looking technologies and process improvements available," as Verizon now asserts, Verizon Answer ¶ 30, then the first step in Verizon's model, the survey process, was unnecessary. Indeed, if the panel was truly positing a forward-looking network *independent* of Verizon's embedded network, as TELRIC requires, it would have had to ignore the surveys because they have no bearing on forward-looking costs in an efficient network. Accordingly, Verizon's current characterization of its NRCM boils down to the untenable assertion that it conducted surveys of actual task times in its embedded network, but that the panel then disregarded them in developing forward-looking work times. Plainly, Verizon's NRCM only makes sense as it was described by Verizon's witnesses and as it was understood by the PSC Staff, the Department of Public Advocate and the Hearing Examiner: the surveys produced actual task times in Verizon's embedded network and the panel adjusted these times to reflect anticipated mechanization of the embedded network. *See* Dean Direct at 35 ("[o]ne forward-looking adjustment is an anticipated 50% improvement in the performance of the Regional CLEC Coordination Center due to an anticipated mechanized advancement").

As such, Verizon's methodology for calculating NRCs is fundamentally flawed. It is based on "[t]he mechanization of [Verizon's] current internal service order processes," an issue that is "irrelevant" to the appropriate legal standard. *McMahon*, 80 F. Supp. 2d at 251. And Verizon's methodology simply fails to consider "the 'most efficient, currently available' telecommunications technology." *Id.* The "hot cut" example discussed above further

demonstrates the critical difference between basing NRCs on projected mechanization of existing, inefficient processes (as Verizon did) and basing NRCs on the most efficient technology available (as TELRIC requires). Verizon's NRCM included four hours of manual coordination activities by its Regional CLEC Coordination Center ("RCCC") associated with the cutover, and its "forward-looking adjustment" consisted of reducing these *manual* coordination activities to two hours based on projected efficiencies. Nov. 13 AT&T Brief at 40. AT&T demonstrated, however, that manual coordination costs are not consistent with a forward-looking efficient network environment *at all* because the coordination functions can be performed electronically by modern OSS. Nov. 13 AT&T Br. at 39-41; Walsh Direct at 43. Accordingly, Verizon's proposed charge is substantially inflated because it assumes two hours of manual coordination activities that would be *unnecessary* in a forward-looking environment.

The PSC's adoption of NRCs based on Verizon's flawed methodology fundamentally undermines the competitive regime adopted in the 1996 Act. Verizon's existing, manual systems do not represent the "most efficient telecommunications technology currently available and the lowest cost network configuration," 47 C.F.R. § 51.505(b)(1). Accordingly, basing NRCs on these embedded systems necessarily results in inflated NRCs that will not permit competition to develop. Indeed, if anything, competitive conditions in Delaware are now behind where they were in 2000, when this Court sent the case back, because the PSC approved anticompetitive NRCs that are inconsistent with fundamental

TELRIC principles. The NRCs recently adopted by the PSC for many key processes are *higher* than those that were struck down as excessive in *McMahon*.[5]

2. The PSC Violated Its Duty To Engage In Reasoned Decisionmaking.

The PSC's Order is also arbitrary and capricious in violation of the PSC's obligation to engage in reasoned decisionmaking. As described above, the PSC and Defendant Commissioners failed utterly in their deliberations and in Order No. 5967 to address the findings of the PSC's own Hearing Examiner and Staff that the Verizon NRCM was fundamentally flawed because it was based on existing, inefficient processes. The PSC and Defendant Commissioners likewise failed to provide a reasoned explanation as to why AT&T's cost model should not be used to set NRCs. *Cf.*, Opinion, *AT&T Communications of New Jersey, Inc., et al.* v. *Bell Atlantic-New Jersey, Inc., et al.*, Nos. 97-5762, 98-0109 (KSH) at 30-31 (D. N.J. June 2, 2000) (unpub.) (finding that the New Jersey Board of Public Utilities' decision to adopt Bell's proposed non-recurring rates was "arbitrary and capricious" because the Board failed to address expert testimony presented by AT&T that undermined Bell's proposed rates); *id.* at 31 ("the Board must address this evidence"). In fact, *no explanation at all* was given by the PSC for using Verizon's embedded cost model in favor of AT&T's forward-looking NRC model. Finally, the PSC failed to provide a reasoned explanation as to why – even assuming that it was appropriate to calculate NRCs by making "forward-looking" adjustments to existing processes – the criticisms of the way in which Verizon made these adjustments, including Verizon's failure to provide any documentation for its adjustments, were not valid. Indeed, the Defendant Commissioners acknowledged that these criticisms were

[5] PSC April 30, 2002 Meeting Tr. at 2384-85.

valid. PSC March 5, 2002 Meeting Tr. at 2323 ("I do agree that what we have is a black box here") (Chairman McRae); *id.* at 2341 ("I'm not pleased with the lack of transparency here to this model") (Commissioner Puglisi); *id.* at 2345 (the NRCM "truly is a black box") (Chairman McRae).

By wholly failing to address these pertinent issues, the PSC's decision to approve Verizon's NRCs is plainly arbitrary and capricious. *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983) ("[A]n agency rule would be arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem"); *Professional Pilots Fed.* v. *FAA*, 118 F.3d 758, 771 (D.C. Cir. 1997) (same). This is particularly true when the PSC failed to "apply the criteria it has announced as controlling," *Squaw Transit Co.* v. *United States*, 574 F.2d 492, 496 (10th Cir. 1978) – that under TELRIC, NRC rates should be based on the cost of the most efficient, currently available technology. *See also Public Citizen* v. *Heckler*, 653 F. Supp. 1229, 1237 (D.D.C. 1986) ("For an agency to say one thing . . . and do another . . . is the essence of arbitrary action"); *New England Coalition on Nuclear Pollution* v. *NRC*, 727 F.2d 1127, 1130 (D.C. Cir. 1984) (same).

CONCLUSION

The PSC Order should be vacated and the matter remanded to the PSC with the renewed directive that the PSC recalculate Verizon's non-recurring costs in accord with the Act, the FCC's rules, and this Court's prior directive in *McMahon*.

Dated: August 5, 2002

By:_____
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CERTIFICATE OF SERVICE

I, Wendie C. Stabler, hereby certify that on August ____, 2002, a copy of the foregoing **Motion for Summary Judgment and Brief of AT&T Communications of Delaware, Inc. in Support of Its Motion for Summary Judgment** was served in the manner indicated on the below-named:

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